India Ratings Upgrades Electronica Finance’s NCDs and Bank Facilities to ‘IND A’/Stable

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India Ratings and Research (Ind-Ra) has upgraded Electronica Finance Limited’s (EFL) debt instruments to ‘IND A’ from ‘IND A-’ with a Stable Outlook as follows:

Details of Instruments

Instrument Type	Date of Issuance	Coupon Rate (%)	Maturity Date	Size of Issue (million)	Rating assigned along with Outlook/ Watch	Rating Action
Non-convertible debentures*				INR3,400	IND A/Stable	Upgraded
Bank facilities	-	-	-	INR18,750	IND A/Stable	Upgraded

*Details in Annexure

Analytical Approach

Ind-Ra continues to take a standalone view of EFL to arrive at the ratings.

Detailed Rationale of the Rating Action

The upgrade reflects EFL’s 30-year operating history in machine financing (MF), which accounted for 65% of its assets under management (AUM) as of FY24, alongside a growing portion of its non-MF assets. The ratings are bolstered by a leverage ratio of 2.50x and strong capitalisation with a capital adequacy ratio of around 27%, following the recent equity investments. EFL’s expanding franchise, evidenced by a 30% yoy increase in AUM to INR37.08 billion at end-FY24, is poised for further growth with the new equity infusion. Notably, the micro loan against property (micro LAP) segment, a high-yielding product, maintained a 19.38% share of AUM at end-FY24. However, this also contributes to overall delinquencies, making its performance a crucial aspect to monitor. Additionally, the ratings highlight EFL’s diversified funding profile, which includes a mix of long-term liabilities that align with the duration of its asset book, and the ability to generate liquidity through loan securitisation or co-lending. The company has sustained its asset quality despite an expanding base, further supporting the upgrade in ratings.

List of Key Rating Drivers

Strengths

- Substantial equity infusion enables franchisee growth
- Expertise in machine financing; business diversification underway
- Established underwriting systems and processes
- Diversified funding profile

Weaknesses

- Performance of micro lap book monitorable

Detailed Description of Key Rating Drivers

Substantial Equity Infusion Enables Franchisee Growth: EFL's capitalisation levels remain strong, with a leverage ratio of 4.6x (debt/ tangible equity) at end-FY24 (FY23: 4.4x, FY22: 3.1x, FY21: 2.2x and FY20: 2.1x). Encourage Capital owns around 16.74% on a fully diluted basis in EFL.

Following a recent series B equity raise of INR4,000 million, with INR3,730 million already received and the remaining INR270 million likely in 3QFY25, the company's tangible net worth surged to around INR8,000 million from INR4,230 million in FY24. Leapfrog Investments has injected INR2,800 million, securing a 20.68% stake on a fully diluted basis, while Aavishkaar Capital has invested INR930 million for a 6.75% stake on a fully diluted basis . Consequently, the leverage ratio has significantly improved to 2.50x with a capital adequacy ratio of around 27% post the equity infusion in June 2024.

This recent equity infusion in the company will play a pivotal role in expanding the franchisee and absorb asset quality issues, if any, to a certain extent. Operating leverage would also play out over a period in time with economies of scale.

This infusion of capital can also assist the company in more efficiently raising debt funding..

Expertise in Machine Financing; Business Diversification Underway:

EFL has a rich history of around three decades in the realm of machine financing. This positions the company with a competitive edge in terms of crucial expertise, encompassing a machine's functionality and resale value. The firm's strong relationships with suppliers and borrowers are evident in the significant portion of repeat business from existing customers, accounting for 35%-37% of its incremental business. EFL has been expanding its branch network (FY24: 217; FY23: 165; FY22: 110; FY21: 65). As of 31 March 2024, EFL operated in 15 states, with nearly 51% of its portfolio concentrated in Maharashtra, Gujarat, and Tamil Nadu. The geographic concentration has been reducing year on year with expansion in new territories.

Furthermore, EFL is gradually diversifying its product mix to cater to additional funding requirements of its borrowers and expanding its exposure to the non-manufacturing borrower base. Its array of offerings includes MF, micro loans against property (micro LAP), loans against property (LAP), institutional lending, solar financing, and other services. MF, its flagship product, accounted for about 65% of its AUM of INR24.53 billion at end-March 2024 (FY23: 67%; FY22: 74%; FY21: 80%). Ind-Ra opines that the gradual expansion into products such as micro LAP can result in enhancing yields, and enhancing the granularity of its loan portfolio, which constituted 19.38% of the total portfolio as of 31 March 2024 (FY20: 3%). Furthermore, the company plans to further diversify its offerings by venturing into residential solar rooftop financing. The company has started a pilot project of residential solar rooftop financing in Gujarat.

Established Underwriting Systems and Processes: EFL’s established presence in MF has bolstered its sourcing, underwriting, monitoring and recovery strategies. The company's lending practices are rooted in the evaluation of cash flow of MSME. Additionally, EFL has developed strategies to safeguard itself against losses resulting from borrower defaults, such as financing standardised machines and maintaining exclusive charge over them. To further mitigate risks, EFL's MFs are predominantly supported by approximately 20% cash collateral or borrower's equity contribution in machinery purchases.

EFL has established partnerships with equipment suppliers, enabling it to conduct business with minimal reliance on any direct-selling agents and identify potential buyers in the event of equipment liquidation.

The management expects the non-MF book to account for 35%-40% of the AUM (FY24: 35.1%; FY23: 33%; FY22: 26%) over the long term, led by micro LAP and solar financing. Both these products have a limited track record, unlike MF, and are still evolving with scale. The underwriting quality for these segments will be a key rating monitorable.

Diversified Funding Profile: EFL’s vintage has enabled it to raise funds from diversified sources, i.e. public sector banks, private sector banks, foreign portfolio investors, development financial institutions, along with large non-banking financial companies (NBFCs). EFL raises funds from these sources through term loans (FY24: 58%; FY23: 70%; 1QFY23: 56%), working capital loans (FY24: 1.5%), direct assignments, pass-through certificates and co-lending (FY24: 26%) and non-convertible debentures (NCDs; FY24: 15. 3%). Its funding from banks and NBFCs accounted for 85% of the outstanding borrowing at FY24 (FY22: 87%; FY21: 84%), with a well-diversified base of about 39 lenders, including 11 public sector banks, 13 private banks and seven NBFCs.

Around 40% of the machines funded by EFL are green machines. The company has also ventured into solar rooftop financing. Both these factors can enable the company to access a wider universe of lenders such as development finance institutions and impact funds. EFL had raised USD7.5 million from a Swiss lender against such green machines and rooftop solar in 1QFY24. Further in 2HFY24, EFL raised EUR7.5 million from Netherland-based funds including funding directly from the Dutch Ministry through their fund 'Dutch Good Growth Fund'. The anticipated foray of the company in these green products can enhance its environmental, social, and governance (ESG) credentials, thereby can lead to broadening its investor base.

Performance of Micro LAP Book Monitorable: EFL managed its asset quality with a collection efficiency of 87%-92% during FY23-FY24. Consequently, its gross non-performing assets (NPAs) reduced to 1.08% (including impact of the Reserve Bank of India's 12 November 2021 circular) at FY23 (FY22: 2.5%; FY21: 2.8%However, subsequently the gross NPAs increased to 2.21% at end-3QFY24, predominantly because of asset quality issues in its micro LAP book within Gujarat as well as NPAs from the legacy industrial LAP book. Furthermore, the gross NPA improved to 1.45% in March 2024. With the expected increase in micro LAP book, the ability of the company to maintain its provision coverage ratio (FY24: 44.3%, FY23: 45.9%, FY22: 49.6%)and asset quality will be a key monitorable.

Furthermore, with the inflationary pressures, EFL's borrowers could witness an increase in working capital requirements, pressuring their cash flows. The company is focusing on growing the micro LAP book, which targets a moderately weak customer profile. While collection efficiency remained in line with the collection efficiency of the total AUM, the performance of micro LAP book would determine the asset quality trajectory of EFL with the seasoning of asset loans, and is a key rating monitorable.

Liquidity

Adequate: As per EFL's asset liability statement as on 31 March 2024, the positive cumulative mismatch stood 7.55% of the total assets in the up to one-year maturity bucket. Even after running a stress-case scenario on the statutory liquidity statement, there was cumulative surplus up-to-five -year bucket.

The company has undrawn sanction limits of around INR1,000 million as of March 2024. Furthermore, as of June 2024, the company's liquidity levels stood at INR3,566.1 million.

The company keeps liquidity in form of fixed deposits and liquid investments, which is sufficient to cover 1.5 months of debt repayment without considering inflow from advances. However. the company has enough liquidity to cover three months of debt repayments and opex in form of cash and unutilised bank lines.

Rating Sensitivities

Positive: The company's ability to scale up the franchise while managing its asset quality and profitability, diversification of funding by raising money through capital market instruments and prudent management of liquidity will result in a positive rating action.

Negative: Sustained deterioration in the liquidity buffers, higher-than-expected asset quality deterioration (the gross NPAs exceeding 5%), leverage exceeding 4.5x on a sustained basis and the weakening of its operating profit buffers beyond Ind-Ra's expectations will result in a negative rating action.

ESG Issues

ESG Factors Minimally Relevant to Rating: Unless otherwise disclosed in this section, the ESG issues are credit neutral or have only a minimal credit impact on EFL, due to either their nature or the way in which they are being managed by the entity. For more information on Ind-Ra's ESG Relevance Disclosures, please click here. For answers to frequently asked questions regarding ESG Relevance Disclosures and their impact on ratings, please click here.

About the Company

Pune-based EFL is a non-deposit taking NBFC engaged in asset financing since 1990. The company extends loans to MSME for various needs such as working capital, MF and property backed financing and solar financing. EFL also finances NBFCs/microfinance institutions and micro LAP loans. The company had a presence in industrial clusters for MSME customers and in tier 2 and tier 3 cities for micro-LAP segment across 15 states through 217 branches at end-March 2024.

Key Financials Indicators

Particulars	FY24	FY23
Total assets (INR billion)	27.33	21.90
AUM (INR billion)	38.02	29.05
Total equity* (INR billion)	4.25	3.51
Profit after tax (INR billion)	0.63	0.40
Return on average assets (%)	2.60	2.19
Source: Company *including CCPS *Ratios calculated as per Ind-Ra's calculations		

Status of Non-Cooperation with previous rating agency

Not applicable

Rating History

Instrument Type	Current Rating/Outlook			Historical Rating/Outlook							
	Rating Type	Rated Limits (million)	Rating	12 March 2024	22 November 2023	21 September 2023	28 June 2023	23 December 2022	11 November 2022	2 August 2022	10 June 2021
Bank facilities	Long-term	INR18,750	IND A/Stable	IND A-/Stable	IND A-/Stable	IND A-/Stable	IND A-/Stable	IND A-/Stable	IND A-/Stable	IND A-/Stable	IND A-/Stable
Non-convertible debentures	Long-term	INR3,400	IND A/Stable	IND A-/Stable	IND A-/Stable	IND A-/Stable	IND A-/Stable	IND A-/Stable	IND A-/Stable	IND A-/Stable	IND A-/Stable

Bank wise Facilities Details

Click here to see the details

Complexity Level of the Instruments

Instrument Type	Complexity
Bank loans	Low
Non-convertible debentures	Low

For details on the complexity level of the instruments, please visit https://www.indiaratings.co.in/complexity-indicators.

Annexure

ISIN	Date of Issuance	Coupon Rate (%)	Maturity Date	Size of Issue (million)	Rating/Outlook
INE612U08025	14 June 2021	11.25	13 June 2027	INR594	IND A/Stable
INE612U07084	21 July 2023	9	21 July 2026	INR450	IND A/Stable
INE612U08033	30 December 2022	12.55	29 June 2028	INR300	IND A/Stable
INE612U07100	31 August 2023	10.67	31 August 2026	INR250	IND A/Stable

INE612U07092	5 September 2023	10.48	5 September 2026	INR250	IND A/Stable
INE612U07118	27 September 2023	10.45	27 October 2026	INR240	IND A/Stable
INE612U08041	28 December 2023	13	28 June 2029	INR350	IND A/Stable
INE612U08041	24 January 2024	13	24 July 2030	INR150	IND A/Stable
INE612U08058	26 March 2024	12.90	26 September 2029	INR200	IND A/Stable
Limit utilised				INR2,784	
Limit unutilised				INR616	
Total				**INR3,400**	
Source: EFL, NSDL					

APPLICABLE CRITERIA

Non-Bank Finance Companies Criteria

Evaluating Corporate Governance

The Rating Process

Financial Institutions Rating Criteria

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